alternatives.[29] The explanation for the large value placed on the so-called intangible assets in such cases is not that monopoly rents are being extracted, but rather that this is the fair market going concern value of the business at that time. Prices paid for cable systems are and have always been based on exactly the same type of valuation.

Cable operators have financed and paid for the intangible value of cable television systems fully expecting to recover their investment and earn a profit on that investment over the duration of the franchise. In other words, the net present value of the investment has been assumed to be positive. If this were not so, no rational investor would have ever committed funds to the purchase of a cable system. Years of valuation of cable systems in an unregulated marketplace have created the current existence and ratios between tangible and intangible assets. Arguments over the high value of current intangibles are irrelevant because cable operators must make the interest payments to service the debt incurred to purchase these assets. This is a very real expense that revenue must cover. Often this revenue can only be generated by earning a return on the intangible assets, as well as the tangible assets, and by including the related amortization expense in the revenue requirement.

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[29]It should be noted that the cash flow multiples paid for broadcast properties in the 1980's often exceeded those paid for cable systems. And, more of the purchase price is for intangibles since the capital expenditure necessary to produce revenue is lower for broadcast stations.

Intangibles now on cable systems' books were incurred through arms-length transactions in an unregulated environment. These costs have been recorded in accordance with GAAP and meet the definition of an asset as a future economic benefit over which the entity can exercise control. Since at the time these costs were incurred cable systems were not regulated entities, the Commission should, at a minimum, permit acquisition adjustments such as those which have been allowed when property is transferred between utilities. Thus, for example, all intangibles now on the books of cable systems could be included in the rate base. In analogous situations, the Commission has allowed telephone plant acquisition adjustments.[30]

Not only is the inclusion of intangibles in the rate base the fair and equitable thing to do, but also their exclusion raises serious constitutional issues. While it is clear that the government has the authority to regulate industry, the Fifth and Fourteenth Amendments to the Constitution have been interpreted to guarantee that the government will not set rates for privately owned industries at a level which would deny the owners a fair return on their investment. The proposed exclusion of intangibles does precisely that: by not allowing cable operators to include the costs of goodwill, customer lists, franchise rights and other similar intangibles in its rate base, the rule sets forth a confiscatory rate mechanism which prevents those

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[30] See, Order on Reconsideration in CC Docket 86-497, 4 FCC Rcd. 1697 (1989), affirmed sub nom Illinois Bell Tel. Co. v. FCC, 988 F.2d 1254 (D.C. Cir. 1993).

choosing a cost of service rate structure from realizing a fair return.

Historically, the courts have held that a rate is too low if it is "so unjust as to destroy the value of [the] property for all the purposes for which it was acquired," and in so doing "practically deprive[s] the owner of property without due process of law." FPC v. Natural Gas Pipeline Co., 315 U.S. 575 at 585 (1942). Moreover, "[i]f the rate does not afford sufficient compensation the State has taken the use of utility property without paying just compensation . . . " Duquesne Light Co. v. Barasch, 299 U.S. 299, 308 (1989).

Because of the realities of the industry, the fees which were paid for goodwill, subscriber lists and franchise rights were "reasonable financial requirements of the industry." Duquesne, supra, at 315. Clearly, a cable system is all but worthless without franchise rights to serve a community. It is also clear that the market places great value on goodwill and subscriber lists. It is wrong for the Commission to retroactively assess the value of the cable systems without including these valuable assets. Ratemaking rules which do not allow the cable operators to include these costs in their rate bases are confiscatory by definition; they reduce the value of the cable companies by decreasing the recovery which can be made on these necessary investments. Only that portion of intangible assets that sound economic tests indicate are truly "monopoly rents" should be excluded from the rate base.

Not only should most if not all intangibles be includable in the rate base, but there should be a permitted amortization of these properly incurred investment costs.[31] The amortization period should reflect a realistic timeframe for recovery of these costs, not the 40-year period suggested by the Commission. Franchises are now non-exclusive, have a measurable life and are not certain of renewal. Thus, the amortization period should not be longer than the remaining life of a franchise.

The Commission asks whether it is reasonable to view accumulated losses as capital invested with the expectation of recovery over future periods.[32] Past losses are just as real in dollar terms as amounts invested in cable plant and have been financed similarly though debt and equity. Lenders expect their loans to be repaid and equity owners expect a return of the total capital invested in the business. Disallowance of deferred losses would result in the confiscation of property and have a chilling effect on the willingness of investors to commit additional funds to cable investment. Disallowance of past

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[31]Historically, the Internal Revenue Service has permitted amortization of intangibles other than goodwill used in a trade or business if the property has an ascertainable limited useful life. See, Newark Morning Ledger Co. v. United States, 113 S.Ct. 1670 (1993). The Omnibus Budget Reconciliation Act of 1993 added a new section 197 to the Internal Revenue Code which affirms and liberalizes the policy. Now, intangibles, including licenses, franchises, going concern value and even goodwill, are amortizable over a 15-year period. This recognition by Congress further bolsters Commenters' contention that virtually all so-called "excess acquisition costs" are properly includable in the rate base of cable systems, both now and in the future.

[32]Notice, n.44.

losses would be inconsistent with the regulatory precept that companies should be given the opportunity to recover their operating costs and earn a reasonable return on their investment.[33] Past losses should be reflected as a component of capitalized investment which should be recoverable over the remaining life of the franchise.

As to plant under construction,[34] existing cable systems rarely have plant in that status for very long. When a system is being rebuilt the new plant is activated as each small part of the project is completed. There is no significant period when new plant stands idle. This is true of line extensions, too. Hookups are made as houses are passed. Thus, this is largely a non-issue for cable systems. New and rebuilt plant should become part of the rate base as it is constructed.[35]

Finally, Commenters submit that cable systems do not have excess capacity as that term is normally understood.[36] When a rebuild is done, or new plant is constructed, a cable system will have more channel capacity than it will immediately program. To call this excess capacity, however, misunderstands cable technology and economics. When a rebuild is being done it costs

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[33]Cf., Democratic Central Committee of D.C. v. WMATC, 485 F.2d 786 (1973).

[34]Notice, ¶ 42.

[35]As to the Commission's question as to whether interest during construction can be capitalized, Commenters note that the Financial Accounting Standards Board requires that interest during construction be capitalized.

[36]Notice, ¶ 43.

very little more to construct a greater channel capacity. It is much less expensive to do this than building to present channel use and then expanding capacity on an as-needed basis later. Moreover, this so-called "excess capacity" is frequently required by franchising authorities as part of a renewal process. The Commission should make clear that other possible definitions of excess capacity are invalid as well, e.g., plant connected to presently non-subscribing homes or a pro rata portion of plant based on the ratio of homes passed not subscribing. The Commission should be specific about these items lest aggressive local regulators attempt to severely restrict cable operators.

b. Working Capital.

A working capital adjustment is generally not a significant item for cable system operators. Requiring a lead/lag study to determine the amount of working capital to include in the rate base would be a large task which is not justified. Commenters presume that the Commission is talking about a rate base adjustment for the average amount of investor-financed cash working capital, not the excess of a company's current assets over its current liabilities. In cable television, there is rarely the kind of lag in recovery of non-cash costs which occurs in certain regulated utilities. Therefore, the use of a simple balance sheet calculation would serve the purpose in a much more efficient fashion than a lead/lag study. In the alternative, an industry-wide working capital allowance might be acceptable if it can be properly determined. One suggestion would be to peg it to a percentage of a system's revenues.

3. Rate of Return.

The Commission has tentatively concluded that it cannot or should not establish a separate rate of return for each franchise area or for each cable company.[37] It also proposes to establish a single rate of return for the provision of regulated cable service by all cable operators. Commenters submit that this one-size-fits-all approach is inappropriate for the cable industry. Commenters do agree that it is not practicable to establish a separate rate of return for each franchise area. However, the cost of capital is not the same for all cable operators. The cost of capital for TCI, for example, is certainly different than the cost of capital for a cable operator owning one or two cable systems. At a minimum, there should be some variable introduced to differentiate a cable operator's particular cost of capital in relation to other operators and the industry in general. A better approach would be to permit each cable company to submit its own rate of return which can then be evaluated against the rate of return of the industry generally and of other similarly situated companies in particular.

The Commission seeks comment on how to balance the goals of protecting consumers and providing incentives for the industry to expand its service offerings.[38] The balancing of these goals

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[37]Notice, ¶46.

[38]Notice, ¶ 47.

must allow an adequate return on the rate base to reflect competitive fair market value of the investment. If investment (and reinvestment) is not encouraged by the Commission's rate setting methodology, a subscriber will not receive any more programming or have any better service in the future than is provided today because cable operators will not have the incentive to provide improved service. More importantly, they may not be able to afford to provide such service.

The Commission has tentatively concluded that it should determine the rate of return of regulated cable service primarily by using an assessment of risk. It further proposes to choose a surrogate that experiences the same approximate risk as regulated cable service. It goes on to tentatively conclude that either the Standard & Poors 400 Industrials ("S&P 400") as a whole or a subgroup of firms in it can constitute a reasonable surrogate for regulated cable service.[39] Assuming that the use of a surrogate is a proper approach, which Commenters do not concede, the use of the S&P 400 is not appropriate. In the first place, the cable industry, unlike the large corporations represented in the S&P 400, relies heavily on private and semi-public sources of capital. Moreover, the S&P 400 has characteristics which are quite dissimilar to the cable industry. Not only is this the case in terms of the source of capital but also because of the size of the companies in that index. The choice of a surrogate to use in determining the rate of return of regulated cable

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[39] Notice, ¶ 50.

service should be guided primarily by an assessment of risk. The cost of capital is an opportunity cost that measures what potential investors would forego by not investing their funds elsewhere in alternative projects with similar risk characteristics. There is clearly no record evidence that the S&P 400 shares the risk characteristics of the average cable company. If, as Commenters believe, the cost of capital for a cable company is higher than that of the S&P 400 and the FCC sets a cost of capital at the S&P 400 level, investors will disinvest in the cable industry because it is earning less than its opportunity cost of capital. This point can be illustrated by comparing the dominant firm in cable television, TCI, with the dominant firm in the telephone industry, AT&T. TCI has a risk premium 1.6 times as great as AT&T (TCI's beta is 1.55 and AT&T's beta is .95). This indicates that TCI should have a higher cost of capital than AT&T. It bears repeating once again that cable television is not a necessity and that competition is increasing. Therefore, if a surrogate approach is to be used, close attention to the comparability of risk factors must be central in setting a rate of return for regulated cable service.

The Commission asks whether it should measure the cost of equity by using the discounted cash flow method or the risk premium analysis method.[40] On balance, Commenters believe that the risk premium analysis method would be preferable. This approach better accounts for the individualized costs of capital

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[40]Notice, ¶ 51.

for particular cable operators. The risk estimator, or beta, is available to assess comparative risk in stocks, and ratings are available for the debt of public companies. Again, it is the huge diversity of companies within the cable industry which drives Commenters' views that one-size-fits-all solutions are wholly inappropriate.

Based on the use of the S&P 400 surrogate the Commission tentatively concludes that the cost of equity will be in the range of 12% to 17%, then, assuming a debt/equity ratio of 50%, the Commission calculates a rate of return for regulated cable service as being approximately 10% to 12.4%.[41] In the first place as stated above, the S&P 400 as a surrogate is entirely inappropriate. Assuming that a proper assessment of the relative risk of the cable television industry is made, the cost of equity will certainly be larger than the 12% to 17% range cited by the Commission. Moreover, the Commission's blithe assumption of a debt to equity ratio of 50% is unfounded. There is no evidence of record to indicate that the cable industry is at this level, nor is any rationale set forth for making this a desirable or target level for the industry. Therefore, the Commission's tentative rate of return range of 10% to 14% is totally devoid of support.

As to the cost of debt, Commenters see no reason why the cost of debt of the chosen surrogate should be used. Indeed, even the idea that one cost of debt should be used for the entire

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[41]Notice, ¶ 52.

industry is not realistic. As pointed out numerous times above, characteristics of companies and individual systems widely differ across the cable television landscape so that even an average cost of debt for the cable industry arrived at without the use of a surrogate would be inappropriate to be applied on an industry-wide basis. Commenters believe that the cost of debt of each individual company should be the proper measurement, not any averages or surrogate figures. As to preferred stock, which has attributes of both debt and common equity, Commenters believe that its inclusion in the cost of debt should be analyzed on a case-by-case basis. Finally, the existing or embedded debt of the cable industry must be accorded considerable weight in determining the appropriate debt cost. In judging the effect of the cost of debt on a cable company it is only reasonable to look at actual debt cost, not hypothetical debt cost. Commenters again reiterate that the existing debt of the cable industry was incurred by prudent investors in an unregulated environment and to artificially disallow the cost of some debt, which is somehow adjudged to be excessive or imprudent, is a grossly unfair approach to a cost of service process.

The Commission asks what test year methodology should be employed for measuring the rate of return for a cable company making a cost of service showing.[42] In general, Commenters believe that the use of historical cost is preferable since it would minimize the administrative burden on cable operators.

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[42]Notice, ¶ 55.

However, documentable future increases in costs should also be allowed. Cable operators should be allowed to pro forma the historical test period for "known and measurable" changes. In short, the cable operator making a cost of service showing should be able to choose the test year it wishes to utilize.[43]

D. Cost Accounting and Cost Allocation Requirements.

The Commission requires cable operators to maintain their accounts in accordance with GAAP.[44] However, the Commission has not specified any accounts that must be maintained or categories of cost that must be derived from accounts for the purpose of demonstrating the cost of service. To that end, the Commission prepared and attached as Appendix A certain new financial and cost accounting requirements, and has asked whether these should be adopted or whether a more comprehensive system of accounting for cost of service showings such as the uniform system of accounts ("USOA") used for telephone companies should be adopted. Commenters urge the Commission not to adopt a cable USOA, particularly not one like the USOA for telephone companies which is set forth in Part 32 of the Commission's rules. Cable operators would have to completely overhaul their charts of accounts, rewrite their computer programs for processing accounts payable, fixed assets and general ledger information and rewrite

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[43]Commenters note that such historical cost results for different operators may well be useful to the Commission as a way to benchmark "reasonable costs." These costs were incurred prior to regulation and not in anticipation of regulation.

[44]47 C.F.R. § 76.924(b).

the routines that generate financial statements. This is an extremely burdensome and disruptive prospect. Indeed, there is no way to write even a simple USOA that will not be disruptive and burdensome to cable operators. The Commission has expressed its hope that cost of service showings will be a "backstop" to its benchmarks, a backstop utilized by a minority of cable operators. It would be unfair to make all cable operators follow a USOA for the sake of a backstop used by only a few operators.

As for Appendix A, Commenters have a few clarifying questions and suggestions. First, Commenters assume that accounting as it is done today can continue and that franchise level accounting is not anticipated. Under "Revenues" in Section 76.1100, does the "Basic Tier Subscription Fees" category include commercial and/or bulk account revenue? The revenue categories "Other Cable Programming Services" and "Other Operating Revenues" should be renamed "Other Unregulated Programming Services" and "Other Unregulated Operating Revenues," respectively. It should be made clear that "Leased Commercial Access Activities" does not include revenue from local origination programming. Under "Operating Expenses," Commenters presume that "copyright fees" on broadcast signals are included in the programming costs which are treated as external costs for future rate adjustment purposes. In Section 76.1101 the term "average annual investment" should not result in penalizing a cable operator who made a significant capital investment shortly before a cost of service showing. The money expended should not be diluted by some averaging calculation. As a general matter in Section 76.1102, not all costs are properly allocable based on the number of subscribers. Flexibility to rationally allocate costs in a way which makes more sense must be left to the cable operator. Both here and in Section 76.1100 there should be an "Equipment/Installation" cost category. It is provided for in "Revenues" in Section 76.1100, but not in expenses. True, these costs are not part of a cost of service showing for service tiers, but they are part of their own cost of service showing and should be part of the accounting rules. Finally, the "Non-Cable Activities" cost category should be defined more clearly so as to avoid confusion.

The Commission asks whether it should adopt different or supplemental cost allocation requirements for purposes of developing cost based rates for regulated cable service different than those described in Sections 76.924(e)(f) and (g) of the rules. Commenters believe that the Commission should not adopt a single method to allocate costs, e.g., by subscriber or subscriber per-channel. There is no rational basis for selecting one method over another. Cable operators should have the flexibility to make allocations in the most realistic manner.

The Commission goes on to discuss a continuum between identifying all the costs of a specific franchise and MSO-wide cost averaging. It is tempting to favor company-wide cost averaging because it would be so much easier to implement and administer a simplified and unitary cost of service approach. However, such a simple approach does not deal appropriately with the economic realities a cable operator must address when it elects to make a cost of service showing. Commenters believe that a large degree of flexibility must be built into the cost allocation guidelines. Generally, many major categories of costs will be identified at least as far up as the regional operating level. Indeed, some costs may be averaged company-wide, but many costs will be franchise specific because of the differences between cable systems described throughout these comments. Therefore, the Commission should allow the cable operator the flexibility to allocate costs in a manner that most accurately reflects reality and should not require all allocations to be done in the same fashion.

III. STREAMLINING ALTERNATIVES

A. General Alternatives.

Commenters applaud the Commission's efforts to find ways to streamline cost of service showings or to provide alternative methods of establishing the proper level of rates short of a full cost of service showing. The first such proposal upon which the Commission seeks comment would conclude that initial rates for cable service will be considered reasonable if they are no higher than 1986 rates adjusted forward both by a general measure of inflation and by a productivity offset.[45] Commenters believe that this can be a workable alternative if done on a per-channel basis. Thus, the rates per channel in 1986 would be compared, as adjusted for inflation, with current rates on a per-channel

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[45]Notice, ¶ 71.

basis.[46] If the current per-channel rate were at or below the 1986 level, the current rates would then be presumed reasonable and no further action would be necessary. In favoring this test, Commenters stress that this "safe harbor" should not supplant the other alternative and streamlined cost of service showings discussed by the Commission. Inflation is only one element of the rate picture.

The next alternative discussed by the Commission would be to permit cable operators to document certain key cost factors, financial characteristics, or other combination of factors that could be said to justify existing rates.[47] This is also a constructive idea. The crucial issue here, however, is to identify those factors which could be used to show that such "add-ons" are assumed to be cost justified, thus obviating the need for a cost of service showing. There is a need to study what factors to include and what is considered ordinary and extraordinary. Commenters believe that the present record does not contain sufficient information to establish these factors and suggest to the Commission that it make this part of the proposed cost studies to make this streamlining alternative a viable one for future use.

A related proposal would establish a simplified cost of service showing, one in which key areas of costs that can account

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[46]See ,infra, regarding Commenters' views that a productivity offset should not be used.

[47]Notice, ¶ 72.

for substantial rate differences would be the only showing which a cable operator would have to make. As in the proposal discussed in the previous paragraph, there is a need to study what factors to include and what factors would be considered ordinary and extraordinary. However, this is a promising path to pursue and Commenters again urge the Commission to conduct the necessary further studies so that this approach might be available during future rate cycles.

The Commission suggests as another alternative a simplified cost of service showing based on the average costs of providing cable service by either all systems or similar systems with defined characteristics rather than a showing based on the individual costs of the system.[48] This is similar to the average cost approach discussed by the Commission in the section of the Notice on cost allocations. As the Commission notes, the cost studies it will be undertaking will explore the possibility of collecting average cost data. If such data can be collected, or if a cable operator has the flexibility and the option of showing average cost data for all of its cable systems, this approach could well be a viable alternative. Average data should not be used to impose a particular cost or standard, but it is acceptable as part of an optional alternative.

Finally, the Commission asks whether it could establish an abbreviated cost of service showing for significant prospective capital expenditures used to improve the quality of service or to

[48] Notice, ¶ 74.

provide additional services.[49] Commenters strongly support this approach. The present benchmark and price cap methodology does not reflect the cost of system upgrades and service improvements at all. This gap in how future rates would be set is glaring. The approach raised by the Commission is intriguing and workable. As the Commission notes, the cost of the upgrade could be added to the benchmark rate, subject to the cost allocation rules adopted by the Commission. Without question this approach would reduce burdens on cable operators and regulators, while at the same time providing assurances to cable operators that expenditures made to improve plant and to provide new services could be recovered on a cost basis.[50]

B. Small Systems.

The Commission raises a number of questions regarding reducing the burden of rate regulation on small systems. Many of these same suggestions and issues have been raised in petitions for reconsideration of the Report and Order in MM Docket No. 92-266 establishing the benchmark rate methodology. Many of the Commenters herein were parties to petitions for reconsideration. Therein, it was suggested that the Commission should establish an exemption for small systems from rate regulation requirements.

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[49] Notice, ¶ 75.

[50] Commenter Falcon Cable TV suggested an alternative test in MM Docket No. 92-266, namely, a "marginal cash flow" test. Although the Commission has incorporated by reference all petitions for reconsideration in that docket into this proceeding, Commenters attach hereto a more complete explanation of the "marginal cash flow" proposal and urge the Commission to give it serious consideration.

Commenters will not repeat those arguments here other than to request the Commission to incorporate them by reference. In sum, Commenters urge that, at a minimum, cable systems, whether owned by an MSO or not, with fewer than 1,000 subscribers be exempted. Commenters have also suggested that the Commission should write a definition of "small systems" which is not confined simply to systems with fewer than 1,000 subscribers but, instead, should look to its own definition of rural systems in the cable/telco context and should also consider applying a density factor as part of its definition. Systems in all three of these categories share the same characteristics. They are small; they are less financially viable than larger systems; and rate regulation, no matter how it is constituted, will impose an immense burden on these systems.

C. Equipment.

The Commission solicits comment on whether the administrative burdens of rate regulation of equipment could be reduced by ascertaining average equipment costs and permitting operators to charge these rates as an alternative to the method of determining equipment charges prescribed in the Report and Order.[51] This is certainly a tempting alternative and many cable systems would undoubtedly wish to avail themselves of such an approach. However, Commenters wish to point out that equipment costs really cannot be fairly averaged. Even within an MSO there are significant differences in the type of equipment used and

[51] Notice, ¶ 79.

their related costs. Averaging under these circumstances would be very fair to some subscribers and very unfair to other subscribers. Thus, Commenters question whether it is worthwhile for the Commission to solicit equipment cost data in order to establish averages. There are more important studies for the Commission to undertake.

IV. OTHER MATTERS

A. Cost Studies.

As discussed above, Commenters favor making a number of cost studies both to inject a note of reality into the cost of service considerations and to provide certain bases for streamlining alternatives. However, Commenters caution the Commission to design the selection process of which systems and companies are asked to respond to make the results of the studies more representative than previous studies have been. Statistical sampling should be used that accounts for different sizes of systems, the different ownership structures of systems and that provides a representative cross-section of the industry.

B. Productivity Offset

The Commission incorporated an annual inflation adjustment into its price cap mechanism governing rates for cable service. Now it asks whether it ought to take productivity gains into account by adopting some kind of a productivity offset.[52] Commenters submit that no productivity offset should be adopted. There are already productivity factors in the benchmark rates.

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[52] Notice, ¶¶ 81 through 85.

Furthermore, productivity gains are factored into the GNP-PI.[53] At this point, Commenters believe there is no valid economic basis for assuming that cable service has been and will be experiencing the kind of productivity gains which would justify adopting a productivity offset. In short, the Commission has no factual foundation to design such an adjustment at this time.

C. Cost Allocation Requirements for External Costs

Commenters oppose applying the proposed cost accounting and cost allocation requirements to the development of external costs.[54] Most of these costs are specific to the franchise or the system. Aggregating or averaging such costs would thus be unnecessary, as well as burdensome.

D. Collection of Information

The 1992 Cable Act requires that cable systems file with the Commission or franchising authority any annual financial information which may be requested.[55] The Commission suggests two alternatives for implementing this provision of the statute: (1) that all systems should submit data annually, or (2) reliance on an annual survey of a selected group of cable systems. The Commission has tentatively concluded that it should adopt the latter approach.[56] Commenters support the Commission's tentative conclusion that it should rely on an annual survey of a sampling

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[53]This is reflected in the Notice at n.97.

[54]Notice, ¶ 86.

[55]Section 623, 47 U.S.C. § 543(g).

[56]Notice, ¶¶ 88, 89.

of cable systems.[57] However, Commenters urge that the Commission survey competitive systems and a random sample of other systems in order to learn more about the differences and similarities. Finally, however tempting it might seem, small systems should not be excluded from the survey because this may bias the results.

The Commission also asks whether it should impose any reporting requirements when systems change ownership.[58] Commenters oppose this suggestion. Many cable operators are private companies and sale information is kept private. There is no reason to force disclosure of this information. The use of GAAP and the Commission's cost accounting rules will ensure adequate record-keeping for cost of service purposes. And, as noted supra, most cable operators will not even be invoking the cost of service "backstop." Thus, there is no need to collect purchase data.

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[57]Filing deadlines for systems to respond should be set 90 to 120 days after the end of their respective fiscal years. A uniform deadline (e.g., based on the calendar year) puts an undue burden on companies using different fiscal years.

[58]Notice, n.105.

CONCLUSION

Commenters urge the Commission to adopt a flexible set of cost of service rules so that those cable systems wishing to avail themselves of this "backstop" may do so without undue complexity or rigidity.

Respectfully submitted,

CABLE TV OF GEORGIA LIMITED PARTNERSHIP
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MID-AMERICA CATV ASSOCIATION
MOUNT VERNON CABLEVISION INC.
NASHOBA COMMUNICATIONS
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APPENDIX A

MARGINAL CASH FLOW TEST AS
A RATE ANALYSIS MECHANISM
SHORT OF COST OF SERVICE REGULATION

Falcon Cable TV ("Falcon") proposes a streamlined mechanism which could be employed by cable systems as a procedural alternative to making a cost of service showing. It is not meant to preclude any other showings or defenses which the Commission may adopt. Falcon's "marginal cash flow" test relies on readily obtainable financial information which can be derived without resort to complex cost-based accounting or a uniform system of accounts and offers a useful mechanism to guard against truly unreasonable rates without impeding the ability of the cable industry to continue to improve its facilities and programming offerings.

As explained in detail below, the "marginal cash flow" test would provide an alternative to a cost of service hearing whereby a cable operator could demonstrate that its basic service rate or a challenged cable programming service rate is not unreasonable so long as the ratio of operating cash flow generated by the system from all cable services to the sum of debt service plus capital expenditures does not exceed 1.20:1.

Procedurally, the "marginal cash flow" test would work as follows. Where a cable operator has failed to satisfy any of the criteria established by the Commission for determining whether a given rate is unreasonable, and thus is faced with a cost of service hearing as the final alternative to a rate rollback, the cable operator would then be allowed to provide the financial data specified by the Commission to allow the marginal cash flow analysis to be undertaken. If the Commission or a franchising authority determines that the data documents a ratio of operating cash flow to debt service plus capital expenditures of 1.20:1 or less, the rate would be deemed reasonable. This is analogous to a summary judgment procedure which would obviate the need for a cost of service hearing. If the marginal cash flow test is not satisfied, the cable operator could always go forward with a full-blown cost of service proceeding or pursue any other available options, such as a rate reduction or prospective credit.

The application of the marginal cash flow test proposed by Falcon is simple, straightforward and readily verifiable. First, system revenues from cable television operations would be calculated. This is a figure which is maintained by all cable operators and is the base for revenues subject to the franchise fee limit codified in Sec. 622 of the 1984 Cable Act. For example, the revenue figure would include, but not be limited to, revenues derived from recurring cable service fees, installations, remote controls and other cable equipment, and advertising. Operating expenses[1] are then deducted from revenue

[1]For the purposes of ease of verification, the calculation would be based on actual operating expenses incurred during the most recent fiscal year (possibly adjusted for inflation or other legally-obligated increases). Taxes and other cash expenses would be included. Partnerships, which do not themselves pay income taxes, would be allowed to factor the pro forma effect for taxes into the expense calculation, so as not to unfairly